INDEX

Page

CITATIONS

Cases:

Statutes:

Miscellaneous:

In the Supreme Court of the United States

OCTOBER TERM, 1974

No. 73-1701

UNITED STATES OF AMERICA, APPELLANT

v.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., ET AL.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

REPLY BRIEF FOR THE UNITED STATES

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1. Appellees, like the Securities and Exchange Commission ("SEC") as *amicus curiae*, misconceive the government's contentions. In summary, the complaint charges in Count I a horizontal combination and conspiracy among members of appellee National Association of Securities Dealers, Inc., to restrain trade in outstanding mutual fund shares by suppressing secondary inter-dealer and secondary brokerage markets. Counts II through VIII allege vertical combinations to suppress such markets through provisions both in sales agreements between broker-dealers and principal underwriters and in underwriting agreements between the named principal underwriters and their mutual funds. The government recognizes that Section 22(d) of the Investment Company Act of 1940, 54 Stat. 824, expressly provides for and requires resale price maintenance with respect to transactions within its terms, *i.e.*, sale at the "current public offering price"

in the primary distribution of mutual fund shares, and in all sales of such shares by dealers to investors if the shares are being currently offered to the public by or through an underwriter. 15 U.S.C. 80a-22(d).

Section 22(d), however, expressly permits underwriters and dealers to sell at any time to other dealers or to the issuing fund at prices other than the vertically-fixed current public offering price. Thus, as the SEC has consistently held since the Act was adopted (see U.S. Br. 35-41), "the offering price is not required to be maintained in the case of sales in which both the buyer and the seller are dealers acting as principals in the transaction." Investment Company Act Release No. 78, March 4, 1941, 11 Fed. Reg. 10992.

Similarly, Section 22(d) does not affect direct sales by investors to each other or sales by investors executed through a broker; as the SEC has "repeatedly" held, "Section 22(d) does not prohibit brokered transactions in funds shares at other than the public offering price" (SEC Br. 45).

2. Like the appellees, however, the SEC is mistaken when it implies (*id.* at 25, n. 28, 56) that this antitrust suit seeks to establish a secondary market in which non-contract dealers, as principals, compete unfairly in the sale of outstanding shares to investors. The secondary dealer market that we contend is permitted by Section 22(d) extends no further than to sales by dealers to other dealers, to the issuing fund itself, or to its underwriters. Regardless of how or from whom he acquired the shares, if the dealer sells for his own account to an investor we do not dispute that the statute now requires that he sell at the current public offering price if such shares are being currently offered to the public by the fund (see

U.S. Br. 7, n. 7, 23, 35). Rather, this suit challenges the collective efforts of the appellees, for the purpose of suppressing the secondary inter-dealer (properly understood) and brokerage markets, to extend the limited resale price maintenance authorized and required by Section 22(d) beyond its carefully-defined limits. Such conduct violates the Sherman Act. *Schwegmann Bros.* v. *Calvert Distillers Corp.*, 341 U.S. 384; *United States* v. *McKesson & Robbins, Inc.*, 351 U.S. 305, 316.[1]

The SEC's recent Report on Mutual Fund Distribution and Section 22(d) of the Investment Company Act of 1940 ("1974 Report") is not directed at dealer sales to other dealers; its focus is on the sale of mutual fund shares by dealers to investors. The portions of the Report concerning limitations on the "secondary dealer market" necessary to prevent "non-contract dealers" from securing unfair competitive advantages over contract dealers (*id.* at 115-121) were addressed to the proposal that Section 22(d) be substantially amended or repealed. If that were to occur, so that dealers could sell outstanding shares to investors at less than the vertically-fixed price, then the report suggested that limitations on the secondary dealer market might be necessary so that non-contract dealers selling to investors could not unfairly take a "free ride" in the promotional efforts paid for by the principal underwriter and its contract dealers. Under existing law, secondary inter-dealer transactions involve no sales to investors and do not raise this "free rider" problem.

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[1]The dilemma posed for the appellee dealers by the need "to walk the tightrope" between criminal liability under the antitrust laws and under the securities laws (Bache Br. 51, n. 106) is illusory. A dealer would be criminally liable under the securities laws only for if it *willfully sold* fund shares "in cut price '*dealer*' transactions" (*ibid.*), whereas it would be criminally liable under the antitrust laws only for *agreeing not to sell* "in cut price 'broker' transactions * * *" (*ibid.*). A broker-dealer's *sale* as dealer at the public offering price would not violate the antitrust laws.

3. Appellees' varied contentions that Section 22(f) authorizes the broad vertical restrictions alleged in Counts II through VIII is not supported by its language or history. Joined by the SEC (*e.g.*, SEC Br. 50-52), appellees contend, in essence, that Section 22(f) authorizes not only "restrict[ions on] the transferability or negotiability" of fund shares (15 U.S.C. 80a-22(f)), but also any contractual arrangement between a fund and its principal underwriter or between the latter and broker-dealers that has the same effect as such restrictions. That argument, however, imputes to Congress a degree of imprecision on this matter that contrasts sharply with the drafting of the other provisions of the Act (see, *e.g.*, U.S. Br. 21-22). For example, the Act refers elsewhere to contracts between funds and their principal underwriters (*e.g.*, 15 U.S.C. 80a-15(b)), and it cannot be assumed that Congress meant the specific language of Section 22(f) to apply to all contractual arrangements that might have effects comparable to the restrictions there described.[2]

Moreover, Congress and the SEC anticipated that competition by funds would regulate sales loads,[3] and re-

[2]If Section 22(d) had the effect that appellees now ascribe to it of requiring that the current public offering price be maintained in all inter-dealer and brokerage transactions, as well as those in the primary distribution chain, it would not have been necessary for the funds, underwriters and dealers to attempt to achieve that result through the contractual restrictions they now seek to justify under Section 22(f).

[3]In the Senate Hearings on the Investment Company Act of 1940, David Schenker, Chief Counsel for the Investment Trust Study, testified that "for the present, at least, we ought to leave that [the sales load issue] to competition among the different distributors." Hearings before a Subcommittee of the Senate Committee on Banking and Currency, on S. 3580, Part 1, 76th Cong., 3d Sess., p. 290.

In the Hearings preceding the Investment Company Act Amendments of 1970, SEC Chairman Cohen stated:

> For twenty-seven years we have been observing the effects of this compromise system hammered out in the summer of 1940. For twenty-seven years the Commission has waited for price com-

strictions on the distribution of shares would have been inconsistent with this expectation. Only in the sale of fund shares to investors was competition expressly restricted, as provided in Section 22(d). The potential for competition beyond the limited provisions of Section 22(d) for resale price maintenance was not eliminated by Section 22(f). On the contrary, that Section was intended to require disclosure of restrictions on the transferability or negotiability of mutual fund shares and to empower the SEC to eliminate or regulate such restrictions "in the interests of the holders of all of the outstanding securities of such investment company." 15 U.S.C. 80a-22(f).

The Commission has never adopted rules under Section 22(f) *requiring* funds to impose restrictions against secondary and brokerage markets, nor has it ever indicated that such restrictions are necessary. The claim that the Commission's silence on this issue represents an ongoing determination that such restrictions are proper is untenable, for inaction or acquiescence by a regulatory agency in the absence of a statutory obligation to act forms no basis for implying immunity from the antitrust laws. *United States* v. *Borden Co.*, 308 U.S. 188, 198-201; *United States* v. *Socony-Vacuum Oil Co.*, 310 U.S. 150, 225-227; see *Baltimore & O. Ry.* v. *Jackson*, 353 U.S. 325, 330-331.

If the SEC, exercising its powers under Section 22(f), were to order funds to impose such restrictions upon their shares, presumably no antitrust liability could arise if

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petition among mutual funds to materialize. It hasn't. [Hearings before the Senate Committee on Banking and Currency, on S. 1659, 90th Cong., 1st Sess., p. 152; accord, Hearings before the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce on H.R. 9510, 9511, 90th Cong., 1st Sess., pp. 57, 142 ("1967 House Hearings").]

funds did so. *United States* v. *Borden Co., supra*; *Parker* v. *Brown*, 317 U.S. 341. But the SEC has not done so.[4] To the contrary, recognizing the danger that the long-suppressed brokerage market could not come into being if the transferability and negotiability of shares were restricted, the SEC itself has warned the NASD and the funds that if they attempt to bypass the SEC's recent proposals under Section 22(d) for a secondary brokerage market by directly restricting the transferability of sales in broker transactions, then the SEC may act under Section 22(f). 1974 Report 104-109. Such action by the SEC will of course be unnecessary if existing vertical restrictions are held to violate Section 1 of the Sherman Act.

In claiming that this antitrust action will inevitably intrude into areas reserved exclusively to the Commission, several appellees have stressed the prayer for relief in the government's complaint (Fidelity Br. 15-16; Wellington Br. 40-42; see also SEC Br. 26, 56-57). The sufficiency of a complaint against a motion to dismiss is governed, however, not by the specific relief requested, but by whether, based on the allegations of the complaint, any relief (including only declaratory relief) might be appro-

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[4]In applying the doctrine of federal preemption to asserted conflicts between state law and federal regulatory authority, an issue that this Court has said is analogous to application of the doctrine of implied repeal to "conflicting federal regulatory schemes" (*Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware*, 414 U.S. 117, 126-127), the Court has often required that the agency unequivocally act so as to create an *actual* conflict before preemption will be found. See, *e.g., Head* v. *New Mexico Bd. of Examiners*, 374 U.S. 424, 432; *Rice* v. *Santa Fe Elevator Corp.*, 331 U.S. 218, 236-237; *Penn Dairies, Inc.* v. *Milk Control Comm'n*, 318 U.S. 261, 278; *H. P. Welch Co.* v. *New Hampshire*, 306 U.S. 79, 83-85. See also *Rice* v. *Chicago Bd. of Trade*, 331 U.S. 247, 255-256.

priate (see U.S. Br. 16-17).[5] Although no question of the propriety of any particular form of relief is now before the Court, when the question of relief is reached in this case the district court could include in a decree appropriate provisions taking into account such action as the SEC had then taken or might take. Cf. *Otter Tail Power Co.* v. *United States*, 410 U.S. 366, 375; *United States* v. *Terminal Ry. Ass'n*, 224 U.S. 383, 412.[6]

4. Appellees' reliance upon the legislative history of the 1970 amendments to the Investment Company Act and prior legislative proposals is misplaced. In the Investment Company Amendments Act of 1970, 84 Stat. 1413, Congress amended Section 22(b) of the Act to give the NASD jurisdiction to adopt rules prohibiting sale loads that are "excessive" rather than merely those that are "grossly excessive" (15 U.S.C. 80a-22(b)) and also reenacted Section 22(d) in full, with only a technical change. 84 Stat. 1422, 1423.

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[5]Noting that several of the appellees accompanied their "motions to dismiss" with documents and affidavits (see A. 117-224, 309-310), and that the government submitted documents in response (A. 230-308), several appellees have suggested that the Court may treat the case as if summary judgment motions had been granted upon the basis of a complete factual record reflecting the fruits of full discovery (*e.g.*, Fidelity Br. 34-36). The district court, however, properly considered the appellees' motions to dismiss as raising "strictly legal" issues concerning the complaint itself (J.S. App. 33, n. 8), and took no note of any of the additional factual submissions. In any event, the implication that the documents submitted by the government—many of which indicate that the appellees have in the past acknowledged the propriety (if not the desirability) of a competitive secondary market (*e.g.*, A. 265-269) — reflect fully what might be developed by discovery and trial, is unfounded.

[6]The government's action does not seek damages. Whether plaintiffs who have filed similar treble damage actions would be entitled to recover damages (assuming proof of injury during the four-year period of limitations) is also an issue the Court need not consider at this time. Compare *Simpson* v. *Union Oil Co.*, 396 U.S. 13, 14; *Chevron Oil Co.* v. *Huson*, 404 U.S. 97, 105-109.

The legislative history shows that Congress was primarily concerned with excessively high sales loads and advisory fees in the mutual fund business. The SEC had originally proposed to remedy the sales load problem by placing a five percent ceiling on the sales loads authorized by Section 22(d), but subsequently reached an agreement with industry representatives to give the NASD authority to prevent "excessive" sales loads, similar to its authority to regulate fairness in the over-the-counter markets. Hearings before the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce, on H.R. 11995, S. 2224, H.R. 13754 and H.R. 14737, 91st Cong., 1st Sess., pp. 182, 865 ("1969 House Hearings"). Because of the limited knowledge about the effect of total abolition of resale price maintenance in the mutual fund industry,[7] the pertinent Senate committee asked the SEC to study the effect of repeal of Section 22(d) and to transmit its findings, when complete, for possible legislative action. 1969 House Hearings 183.

Congress' failure in 1970 to amend or repeal the resale price maintenance provisions of Section 22(d) therefore signifies nothing more than a reluctance to act without some estimation of the effects of its action. Cf. *Zuber* v. *Allen*, 396 U.S. 168, 185-186, n. 21 ("Congressional inaction frequently betokens unawareness, preoccupation, or paralysis"). The principal issue being outright repeal of Section 22(d) and elimination of resale price mainte-

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[7]According to SEC Chairman Budge:

> The reason the Commission did not recommend the repeal of section 22(d) was because it was represented to us by the industry that disaster would result from the repeal of section 22(d). We had no meaningful way of measuring whether or not that was true and simply on a conservative basis we did not want to make the recommendation without more knowledge about it. [1969 House Hearings at 183.]

nance in the primary distribution chain, the hearings and reports understandably did not focus on secondary brokerage or inter-dealer transactions, which are presently of limited significance (U.S. Br. 9-10). See *T.I.M.E., Inc.* v. *United States*, 359 U.S. 464, 477-478.

Like the district court (J.S. App. 53), appellees stress[8] an extemporaneous response by then SEC Chairman Cohen, in testifying three years prior to the 1970 amendments, in which he made an oversimplified statement of the scope of Section 22(d) during intense questioning by Congressman Watkins concerning the SEC's alleged infringements on states' rights and "competitive business." In this context, in attempting to show that interference with competition in the mutual fund business in general reflected the action of Congress, not the Commission, Chairman Cohen stated (1967 House Hearings 711):

> I am sorry, sir. The statute is unequivocal. No person, no matter where he got it, from the issuer, from another dealer, or even from a private person, no broker-dealer may sell a share of a particular fund at a price less than that fixed by the issuer.

This characterization of Section 22(d) was overstated, for it failed to include the significant qualification that the fixed resale price provision applies to the sale of fund shares only when the fund is currently offering such shares to the public. Nor can it properly be regarded as a considered repudiation of the SEC's longstanding interpretation of Section 22(d). Significantly, the SEC itself, in its *amicus* brief, fails to mention Chairman Cohen's statements. To the contrary, the SEC explicitly rejects the district court's conclusion (and the appel-

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[8]See Bache Br. 75; Fidelity Br. 32, n. 41; NASD Br. 35-36; Wellington Br. 37.

lees' contention), based on that testimony, "that a secondary *brokerage* market is inconsistent with Section 22(d) * * *" (SEC Br. 45; emphasis in original).[9]

5. Having held that the SEC has exclusive jurisdiction over the subject matter of the government's antitrust complaint, the district court stated that "the cases at bar do not involve the doctrine of primary jurisdiction" (J.S. App. 66, n. 59). The broker-dealer appellees contend in passing (Bache Br. 119, n. 297) that the case should be referred to the SEC if the latter's jurisdiction is not held to be exclusive.

If this Court agrees with our contention that the SEC does not have exclusive jurisdiction, then the question of the SEC's primary jurisdiction, which has not been briefed, should be left for the district court to consider in the first instance with other issues on remand. See *Thill* v. *New York Stock Exch.*, 469 F.2d 14, 15 (C.A. 7); cf. *Ricci* v. *Chicago Mercantile Exch.*, 409 U.S. 298.[10] We note only that the SEC's views as to secondary brokerage and inter-dealer markets have been on record since 1941 (see U.S. Br. 35-39), and in its recent Mutual Fund Report it has ruled that impediments to a secondary brokerage market are inconsistent with the general objectives of the securities laws. Since the agency has already spoken, "in prior releases or opinions," there would seem to be no need to

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[9]With respect both to appellees' and the SEC's references to interpretations of Section 22(d) by dealers who would be adversely affected by it or by the NASD's actions in implementing it and to the views of opponents seeking its repeal (*e.g.*, Bache Br. 55-57; SEC Br. 44, n. 95; Wellington Br. 34), we note this Court's caution "against the danger, when interpreting a statute, of reliance upon the views of its * * * opponents. In their zeal to defeat a bill, they understandably tend to overstate its reach." *National Labor Relations Board* v. *Fruit & Vegetable Packers*, 377 U.S. 58, 66.

[10]We have set forth our views on primary jurisdiction under the Securities Exchange Act more fully in our brief *amicus curiae* in *Gordon* v. *New York Stock Exch.*, No. 74-304, certiorari granted November 18, 1974, and are providing copies to counsel for the appellees.

refer this matter to it. *United States* v. *Western Pac. Ry.*, 352 U.S. 59, 69; see *United States* v. *Philadelphia Nat'l Bank*, 374 U.S. 321, 353.

6. All appellees suggest in various ways that the relatively limited element of competition in the secondary brokerage and inter-dealer markets sought by the government's complaint would disturb order in and undermine the entire primary distribution system. In response we quote the Commission's observation in a related context:

> an exaggerated fear of disorderly distribution should not be permitted to form a pretext for avoiding the introduction of price competition which, while perhaps difficult and even unprofitable for particular funds and their underwriters, and certain dealers, would be to the benefit of investors and the [mutual] fund industry generally. [1974 Report 115.]

For the reasons stated in the Brief for the United States and this reply brief, the judgment of the district court should be reversed.

Respectfully submitted.

ROBERT H. BORK,
Solicitor General.

MARCH 1975.

DOJ-1975-03

(Slip Opinion)

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Lumber Co.*, 200 U.S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

UNITED STATES *v.* NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., ET AL.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

No. 73–1701. Argued March 17, 1975—Decided June 26, 1975

Section 22 (d) of the Investment Company Act of 1940 provides that "no dealer shall sell [mutual fund shares] to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus." Section 22 (f) authorizes mutual funds to impose restrictions on the negotiability and transferability of shares, provided they conform with the fund's registration statement and do not contravene any rules and regulations that the Securities and Exchange Commission (SEC) may prescribe in the interests of the holders of all of the outstanding securities. Section 2 (6) of that Act defines a "broker" as a person engaged in the business of effecting transactions in securities for the account of others, and § 2 (11) defines a "dealer" as a person regularly engaged in the business of buying and selling securities for his own account. The Maloney Act of 1938 (§ 15A of the Securities Exchange Act of 1934) supplements the SEC's regulation of over-the-counter markets by providing a system of cooperative self-regulation through voluntary associations of brokers and dealers. The Government brought this action against appellee National Association of Securities Dealers (NASD), certain mutual funds, mutual-fund underwriters, and broker-dealers, alleging that appellees, in violation of § 1 of the Sherman Act, combined and agreed to restrict the sale and fix the resale prices of mutual-fund shares in secondary market transactions between dealers, from an investor to a dealer, and between investors through brokered transactions, and sought to enjoin such agreements. Count I of the complaint charged a horizontal combination and conspiracy among NASD's members to prevent the growth of a secondary dealer market in

the purchase and sale of mutual-fund shares, the Government contending that such count was not to be read as direct attack on NASD rules, but on NASD's interpretations and appellees' extension of the rules so as to include a secondary market. Counts II–VIII alleged various vertical restrictions on secondary market activities. The District Court dismissed the complaint on the grounds that §§ 22 (d) and (f), when read in conjunction with the Maloney Act, afforded antitrust immunity from all of the challenged practices. It further determined that, apart from this statutory immunity, the pervasive regulatory scheme established by these statutes conferred an implied immunity from antitrust sanction. The court concluded that the § 22 (d) price maintenance mandate for sales by "dealers" applied to transactions in which a broker-dealer acts as statutory "broker" rather than a statutory "dealer," and thus that § 22 (d) governs transactions in which the broker-dealer acts as an agent for an investor as well as those in which he acts as a principal selling shares for his own account. *Held:*

1. Neither the language nor legislative history of § 22 (d) justifies extending the section's price maintenance mandate beyond its literal terms to encompass transactions by broker-dealers acting as statutory "brokers." Pp. 15–24.

(a) To construe § 22 (d) to cover all broker-dealer transactions would displace the antitrust laws by implication and also would impinge on the SEC's more flexible authority under § 22 (f). Implied antitrust immunity can be justified only by a convincing showing of clear repugnancy between the antitrust laws and the regulatory system, and here no such showing has been made. P. 23.

(b) Such an expansion of § 22 (d)'s coverage would serve neither this Court's responsibility to reconcile the antitrust and regulatory statutes where feasible nor the Court's obligation to interpret the Investment Company Act in a manner most conducive to the effectuation of its goals. Pp. 23–24.

2. The vertical restrictions sought to be enjoined in Counts II–VIII are among the kinds of agreements authorized by § 22 (f), and hence such restrictions are immune from liability under the Sherman Act. Pp. 24–33.

(a) The restrictions on transferability and negotiability contemplated by § 22 (f) include restrictions on the distribution system for mutual-fund shares as well as limitations on the face of the shares themselves. To interpret the section as covering

Syllabus

only the latter would disserve the broad remedial function of the section, which, as a complement to § 22 (d)'s protection against disruptive price competition caused by dealers' "bootleg market" trading of mutual-fund shares, authorizes the funds and the SEC to deal more flexibly with other detrimental trading practices by imposing SEC-approved restrictions on transferability and negotiability. Pp. 25–29.

(b) To contend, as the Government does, that the SEC's exercise of regulatory authority has been insufficient to give rise to an implied immunity for agreements conforming with § 22 (f) misconceives the statute's intended operation. By its terms § 22 (f) authorizes properly disclosed restrictions unless they are inconsistent with SEC rules or regulations and thus authorizes funds to impose transferability or negotiability restrictions subject to SEC disapproval. Pp. 30–32

(c) The SEC's authority would be compromised if the agreements challenged in Counts II–VIII were deemed actionable under the Sherman Act. There can be no reconciliation of the SEC's authority under § 22 (f) to permit these and similar restrictive agreements with the Sherman Act's declaration that they are illegal *per se*. In this instance the antitrust laws must give way if the regulatory scheme established by the Investment Company Act is to work. Pp. 32–33.

3. The activities charged in Count I are neither required by § 22 (d) nor authorized under § 22 (f), and therefore cannot find antitrust shelter therein. The SEC's exercise of regulatory authority under the Maloney and Investment Company Acts is sufficiently pervasive, however, to confer implied immunity from antitrust liability for such activities. Pp. 33–38.

374 F. Supp. 95, affirmed.

POWELL, J., wrote the opinion of the Court, in which BURGER, C. J., and STEWART, BLACKMUN, and REHNQUIST, JJ., joined. WHITE, J., filed a dissenting opinion, in which DOUGLAS, BRENNAN, and MARSHALL, JJ., joined.

NOTICE: This opinion is subject to formal revision before publication in the preliminary print of the United States Reports. Readers are requested to notify the Reporter of Decisions, Supreme Court of the United States, Washington, D.C. 20543, of any typographical or other formal errors, in order that corrections may be made before the preliminary print goes to press.

SUPREME COURT OF THE UNITED STATES

No. 73-1701

United States, Appellant,
v.
National Association of Securities Dealers, Inc., et al.

On Appeal from the United States District Court for the District of Columbia.

[June 26, 1975]

Opinion of the Court by MR. JUSTICE POWELL, announced by MR. JUSTICE BLACKMUN.

This appeal requires the Court to determine the extent to which the regulatory authority conferred upon the Securities and Exchange Commission by the Maloney Act and the Investment Company Act of 1940 displaces the strong antitrust policy embodied in § 1 of the Sherman Act. At issue is whether certain sales and distribution practices employed in marketing securities of open-end management companies, popularly referred to as "mutual funds," are immune from antitrust liability. We conclude that they are, and accordingly affirm the judgment of the District Court.

I

An "investment company" invests in the securities of other corporations and issues securities of its own.[1]

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[1] The Investment Company Act of 1940 defines "investment company" to include any issuer of securities which

"(1) is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities;

"(2) is engaged or proposes to engage in the business of issuing

Shares in an investment company thus represent proportionate interests in its investment portfolio, and their value fluctuates in relation to the changes in the value of the securities it owns. The most common form of investment company, the "open end" company or mutual fund, is required by law to redeem its securities on demand at a price approximating their proportionate share of the fund's net asset value at the time of redemption.[2] In order to avoid liquidation through redemption, mutual funds continuously issue and sell new shares. These features—continuous and unlimited distribution and compulsory redemption—are, as the Court recently recognized, "unique characteristic[s]" of this form of investment. *United States* v. *Cartwright*, 411 U. S. 546, 547 (1973).

The initial distribution of mutual-fund shares is conducted by a principal underwriter, often an affiliate of the fund, and by broker-dealers[3] who contract with that

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face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or

"(3) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis." 15 U. S. C. § 80a-3 (a).

This broad definition is qualified, however, by a series of specific exemptions. See *id.*, §§ 80a-3 (b) and (c).

[2] See 15 U. S. C. § 80a-2 (a)(32); *id.*, § 80a-22 (e).

Management investment companies whose securities lack this redeemability feature are defined as "closed-end" companies, *id.*, § 80a-5, and their sales and distribution practices are regulated under § 23 of the Act. *Id.*, § 80a-23. Section 22, the provision under consideration in this appeal, governs the sales and distribution practices of "open-end" companies only.

[3] In this opinion we will use the term "broker-dealer" to refer generally to persons registered under the Securities Exchange Act of 1934, 15 U. S. C. § 78o *et seq.*, and authorized to effect trans-

underwriter to sell the securities to the public. The sales price commonly consists of two components, a sum calculated from the net asset value of the fund at the time of purchase, and a "load," a sales charge representing a fixed percentage of the net asset value. The load is divided between the principal underwriter and the broker-dealers, compensating them for their sales efforts.[4]

The distribution-redemption system constitutes the primary market in mutual-fund shares, the operation of which is not questioned in this litigation. The parties agree that § 22 (d) of the Investment Company Act requires broker-dealers to maintain a uniform price in sales in this primary market to all purchasers except the fund, its underwriters, and other dealers. And in view of this express requirement no question exists that antitrust immunity must be afforded these sales. This case focuses, rather, on the potential secondary market in mutual-fund shares.

Although a significant secondary market existed prior to enactment of the Investment Company Act, little presently remains. The United States agrees that the

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actions or induce the purchase or sale of securities pursuant to the authorization of that Act. We also will refer separately to "brokers" and "dealers" as defined by the Investment Company Act, see 15 U. S. C. §§ 80a-2 (a)(6) and (11), to describe the capacity in which a broker-dealer acts in a particular transaction.

[4] The Act defines "sales load" to be the difference between the public offering price and the portion of the sales proceeds that is invested or held for investment purposes by the issuer. *Id.*, § 80a-2 (a)(35). Most mutual funds charge this sales load in order to encourage vigorous sales efforts on the part of underwriters and broker-dealers. There are some funds that do not charge this additional sales fee. These "no load" funds generally sell directly to the investor without relying on the promotional and sales efforts of underwriters and broker-dealers. See SEC Report of the Division of Investment Management Regulation, Mutual Fund Distribution and § 22 (d) of the Investment Company Act of 1940, 112 (August 1974) (hereinafter 1974 Staff Report).